

General Information Letter: Individuals may carry over losses only as allowed in computing federal adjusted gross income.

January 12, 2001

Dear:

This is in response to your letter of November 1, 2000 in which you request a private letter ruling. Department rules require that the Department issue two types of rulings, private letter rulings and general information letters. The Department has adopted rules concerning letter rulings and other information issued by the Department (*2 Ill. Adm. Code 1200*). We would be happy to send you a copy of those rules at your request.

Although you have not requested either type of ruling on behalf of your company, the nature of your questions and the information you provided necessitates that we respond in the form of general information letter. A general information letter, which is designed to provide general information, is not a ruling that is binding on the Department.

In your letter you wrote:

This letter is written to request a private letter ruling from your office. I have a question regarding Illinois individual income tax, at-risk carryovers, and net operating losses.

I have an individual client who is a shareholder in an S corporation. In 1997 and 1998 the S corporation conducted business exclusively in Illinois and incurred substantial losses. Although the losses of the S corporation flowed through to him, because he did not meet the requirements of IRC Sec. 465, he was not at-risk for the losses and was unable to deduct them on either his federal or his Illinois individual income tax return. In 1999 the S corporation merged with another S corporation with my client maintaining ownership in the surviving S corporation. In 1999 the survivor S corporation conducted business in approximately 35 states and had significant taxable income. The taxable income of the S corporation was sufficient to eliminate all at-risk carryovers for federal purposes. However, as the pre-1999 at-risk carryovers were all sourced to Illinois, for state purposes he only recognized Illinois income of an amount equal to approximately 12% of his Illinois at-risk carryovers. If all the at-risk carryovers are freed up for Illinois purposes, an Illinois net operating loss results.

Do the at-risk carryovers from pre-1999 losses that are greater than his 1999 Illinois income continue to carry over until they are exhausted? As there are no longer any at-risk carryovers for federal purposes, are the pre-1999 Illinois losses freed up in 1999, in spite of the fact that Illinois income in 1999 was still substantially lower than the amount of the pre-1999 at-risk carryovers? Is the resulting loss (assuming the pre 1999 at-risk carryover is freed up for Illinois) available for carryover?

DISCUSSION

Section 203(a) of the Illinois Income Tax Act states in part:

In general. In the case of an individual, base income means an amount equal to the taxpayer's adjusted gross income for the taxable year as modified by paragraph (2).

(2) Modifications. The adjusted gross income referred to in paragraph (1) shall be modified by adding thereto the sum of the following amounts...

Since the calculation of the Illinois income tax begins with federal adjusted gross income, a taxpayer is limited by its federal figures unless another section of the IITA adds back or subtracts from the federal adjusted gross income. No section of the IITA allows an individual who has negative Illinois net income to carryover or deduct that negative amount in another year. Accordingly, your client may not carry over only federal losses taken into account in 1999 and in excess of other Illinois income.

In addition, it appears from your inquiry that you believe a federal loss carryover deduction is apportioned to Illinois using the apportionment factors of the loss year, rather than those of the year in which the deduction is taken. Section 304 of the IITA provides only for use of the current year's factors, and so use of the loss year's factors to apportion a carryover deduction is not permitted.

As mentioned above, this is merely a general information letter and not a statement of policy and is not binding upon the Department. I hope that this has been helpful to you. The Department maintains a website, which can be accessed at www.revenue.state.il.us. If you have additional questions please feel free to contact me at the above address.

Very Truly Yours,

Charles E. Matoesian
Associate Counsel - Income Tax Division